Uncertain times

Laura Blows explores the recent government confirmation that the landmark McCloud court ruling will apply to all public sector schemes and what can be done to prepare for unknown changes

Summary

- The Court of Appeal's McCloud case ruling that changes the government made to judges and firefighter's pensions were discriminatory on the grounds of age, does apply to all public sector pension schemes.
- The changes made are expected to cost around £4 billion a year from 2015, so making the cost £16 billion to date.
- One element of the valuations of public service pensions, the 'cost control mechanism', is delayed until the solution to the McCloud court ruling is revealed.
- The ruling is likely to particularly impact LGPS contractor services.
- No decisions have been made regarding the timeline for change.
- In preparation, administrators can identify and ensure they have accurate data for potentially affected members.

July saw confirmation that the Court of Appeal ruling, that government changes to judges and firefighter's pensions were discriminatory on the grounds of age, applies to all public sector pension schemes.

In a written response to the ruling, following the decision by the Supreme Court to deny the government an appeal, Chief Secretary to the Treasury, Elizabeth Truss says: "The court has found that those too far away from retirement age to qualify for 'transitional protection' have been unfairly discriminated against.

"As 'transitional protection' was offered to members of all the main public service pension schemes, the government believes that the difference in treatment will need to be remedied across all those schemes. This includes schemes for the NHS, civil service, local government, teachers, police, armed forces, judiciary and fire and rescue workers."

Firefighters and a group of 230 judges won their legal case against the government that changes made to their pension schemes were discriminatory back in December 2018, known as the McCloud ruling, with the government being denied the right to appeal. The two cases were ruled on together due to overlapping similarities, and earlier conflicting outcomes at Employment Tribunals.

Changes were made to the firefighters' pension scheme in 2015, and the Fire Brigades Union (FBU) argued that the protection imposed on younger members was unlawful on age discrimination grounds.

The 2015 changes meant that older members could stay in the existing and 'better' pension scheme, and younger members had to transfer to a new and 'worse' scheme, causing financial losses. The FBU initiated over 6,000 Employment Tribunal claims alleging that the changes amounted to unlawful age discrimination.

The challenge from the 230 judges, involved similar circumstances when they challenged the government's decision to force younger judges to leave the Judicial Pension Scheme.

The judges argued that this was discriminatory on the ground of age. Because of recent drives to increase diversity in the judiciary, many more of those in the younger group of judges are female and/or from a BAME background, and so claims were also pursued for indirect race discrimination and a breach of the principle of equal pay.

In her statement, Truss defended the changes made to the schemes in 2015.

She said: "The reasons for the 2015 reforms remain: that public service pensions are a significant cost for the taxpayer, now and in the future. The judgment does not alter the government's commitment to ensuring that the cost of public service pensions are affordable for taxpayers and sustainable for the long term."

Impact

Truss may be standing firm by the 2015 reforms, but the recent ruling confirms that the protections put in place for some members when the pension benefits were changed in 2015 amounted to unlawful age discrimination. So changes have to be made, and they're likely to have a considerable impact. Truss herself states that initial estimates of the cost for government to be around £4 billion.

According to ITM consultant Virginia Burke, it is likely that the remedy, when it is announced, will likely lead to retrospective benefit changes for members, so Truss' estimated £4 billion a year, backdated from 2015, will see costs of approx £16 billion so far.

A further financial effect it has already generated is that relating to the 'cost control mechanism'.

"Because of the 'real risk' that the government would be unsuccessful in its application to the Supreme Court to appeal the Court of Appeal's judgment, and thus more pension contributions would be required from public sector employers, the government announced it was to 'pause' one element of the valuations of public service pensions, the 'cost control mechanism' introduced by the Public Service Pensions Act 2013," Aries Insight director Ian Neale explains.

"In September 2018, the government had announced that provisional results indicated that the cost control mechanism would be engaged. Where the value of the pension scheme to employees has changed from the levels set when reformed pension schemes were introduced in 2015, steps must be taken to return costs to that level. This meant that because costs had fallen as a result of reforms in 2015, automatic improvements to member benefits follow.

"Meanwhile, however, employer contribution rates to unfunded public sector schemes from 1 April 2019 have been implemented as if the cost cap pause had not happened, meaning significant increases anyway (43 per cent in the case of the Teachers' Pension Scheme). This is to address deficits that would otherwise follow the reduction in the Superannuation Contributions Adjusted for Past Experience discount rate to 2.4 per cent plus CPI, announced at Budget 2018 (in line with established methodology to reflect OBR forecasts for long-term GDP growth)."

Aon principal consultant, Madalena Cain, warns that the judgment could also cause real issues for organisations using the Local Government Pension Scheme (LGPS), whether they are companies providing outsourced services or others, such as charities and universities. "Unlike other public sector schemes, the LGPS is a funded arrangement where the cost of any benefit improvements would be passed onto participating employers – and at a time when pension costs are already high," she says.

Due to the nature of the LGPS, there is likely to be a divergence in experience across different employers, Cain explains, depending on which employees are eligible for membership and whether any arrangements are in place to share pension risk with public sector bodies. Contractors who are anticipating exiting the LGPS in the near term are likely to face considerable uncertainty on any exit payments due – and should review their contract terms as a priority.

"It's also possible that contractors could be in the position of bidding for contracts with no clear understanding of the nature and cost of benefits. This could mean higher loadings in the bids and hence poorer value for government," she adds.

To put a somewhat positive spin on the uncertain situation, Neale adds that this has at least exposed the 'elephant in the room'; the "gargantuan estimated £1.5 trillion public sector pensions deficit, to wider scrutiny".

Preparation

But what can those managing public sector pension schemes, with their £1.5 trillion deficit, do to prepare for the upcoming turmoil?

According to Aon, as yet no decisions have been made regarding the timeline for change but all organisations who employ staff with a right to pension benefits through the public sector pension schemes should at least be prepared for additional cost pressures and a further period of prolonged uncertainty about staff benefits.

"Whilst we await details of the remedy for the various public service pension schemes, we know that there must be some form of uplift for those who have been discriminated against," Burke says.

To prepare, Burke recommends that administrators identify members that are likely to be affected, such as active members who may need to have benefits recalculated on their old scheme basis (or with an underpin in the case of the LGPS), members who were switched to a new benefit basis under the reforms and who have since taken benefits from the scheme, and members whose options were changed by the introduction of the new schemes.

"Carrying out this step sooner rather than later will help administrators understand the size of the task facing them and to plan data collection and resourcing ahead of time," Burke says.

It then may be possible to estimate, based on the data already held, whether or not a member who has already taken benefits would have been better off under the remedy, Burke adds. This could avoid the need to obtain data or carry out full calculations for members where it can be demonstrated that the remedy would not have a positive impact based on reasonable assumptions.

Administrators can then calculate benefits using the remedy for those affected, including any underpayments for those who have already taken benefits. For members who are still active this will mean system changes to ensure that future benefit calculations are performed on the remedy basis for the appropriate period.

Finally, looking at comms, Burke highlights that the message that benefits are being remedied due to government discrimination against younger public servants needs to be carefully handled in order to protect member confidence in their pension scheme.

"Whilst there are many uncertainties, schemes can put in place the project framework and carry out an estimate of the members in scope, saving time and effort once the McCloud remedy becomes clearer, allowing the changes to be implemented quickly," Burke says.

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